RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 13, 1990 **LETTER 1045**

June 1 DJIA 2900.97; PTI 3278; A-D Ratio -9.56
June 8 DJIA 2862.38; PTI 3272; A-D Ratio -9.77
Dow Yield: 3.70%; Dow P/E: 13.8; DowPow: 437
Dow Book Value: 1075; Dow 200-day MA: 2703
Percentage of Undervalued Blue-chips: 20%
PTI 89-day Moving Average: 3258

CAPSULES: On June 5 crude oil broke sharply to $16.72 a barrel, its lowest price since early 1989. The latest break is great for the carriers but not good at all for the oil producing states.

Over the last 12 months federal debt (with which I measure the true US deficit) has **increased $319 billion** or at the rate of $6.13 billion a WEEK. Am I the only one in the country worrying about the debt? Is anyone out there?

The rate of credit growth in the US has broken below a 40-year rising trendline. Meanwhile, actual total credit debt (all sectors) as a percentage of GNP has risen to record levels. Thus, the burden of carrying the nation's enormous debts grows ever larger. Corporate debt as a percentage of after tax profits has gone through the roof.

With it all, the stock market seems to like what it sees. What is the market looking at? Is it the opportunity to sell to the Soviets and Eastern European -- what will they pay with? Is it stagflation in the US with steady to lower interest rates? Is it simply rising corporate earnings from here? Or do the markets believe that the chances for recession have completely faded away? Only time will tell, but the market (so far) obviously likes something out there.

The market advance has been led by the big capitalization stocks, as seen in the series of new highs in the Dow and the S&P 500. The smaller stocks (less than 500 employees) account for fully half the nation's GNP, and these companies have been lagging. Even so, the rush into the large cap stocks has started to rub off on the medium to smaller stocks. On June 4 the A-D ratio rallied above its March 8 peak (see page 2 chart).

And suddenly, everyone wants to be in the market -- the institutions via direct stock purchases, and the public via mutual funds. It's been a rush ever since mid-May.

On June 4 the upside action was impressive. On that day breadth was good, and the following averages closed at new 1990 highs or record highs. The Dow, the S&P 500, the S&P Industrials, the NYSE Composite, the NASDAQ Composite and the Wilshire 5000.

The bond market evidently views the unemployment figures and the generally sluggish economic statistics bullishly. The rising bond market in turn fuels the stock market.

The World Index of stock indices is down 7.9% for the year so far.

TACTICS: How can you fault a market that is climbing? Better still, why fault a market that is climbing? My answer is that I'm not interested in faulting the market -- this market or any other market. What I do direct my thoughts and energies toward is investing intelligently. To invest intelligently, I think in terms of (1) conservation of capital, (2) "safe" appreciation of capital, (3) increasing income -- as long as I can increase it "safely."

I never argue with a rising market. I may not choose to enter it, but I don't argue with it. Furthermore, regardless of whether I'm in it or not, I never begrudge a market advance. I learned long ago that I'm going to miss some moves, and I'm going to simply pass on other moves. "The market is always there," runs the old adage. And one happy fact about the investment business -- you can pick and choose your spots. If you don't like the market today, you may love it a month or six months or a year from now.

When I buy stocks I think in these terms and in this order: (1) potential risk, (2) potential profits, (3) taxes.

The greater the value area the market is in -- the lower the risk. Therefore, I place a great deal of emphasis on value.

The more oversold the market, the greater the potential for a major, long-lived rise. The massive, extended advances in the stock market have almost always sprung from fiercely oversold areas.

Taxes (state and federal) will eat up from 33% to almost 50% of any profits we may take out of the market. However, if we sustain losses, we can only deduct $3,000 a year. Therefore, trading the market becomes a ticklish proposition, and what I try to do is limit risk as much as possible.

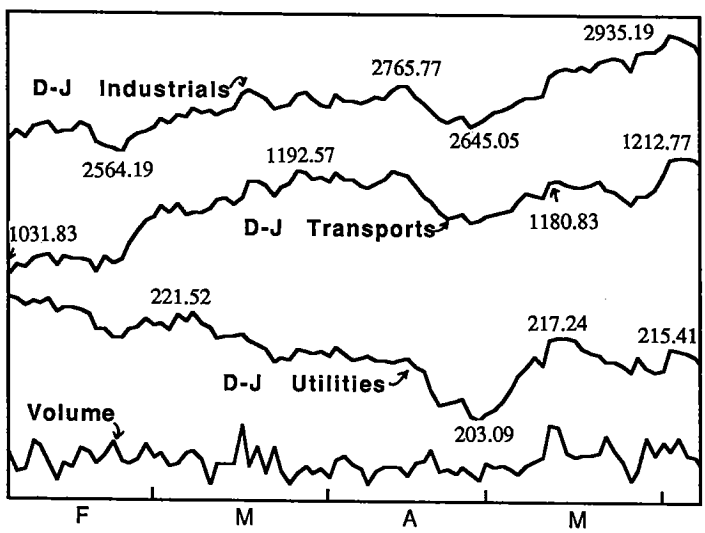
To do that, ideally I want to buy real values at major oversold areas. Any fool can jump in and buy stocks at every decline low. But as the old saying goes, "A fool and his money are soon parted." Therefore, the Russell philosophy is to enter the market (1) only when I can buy good values, and (2) only at major oversold areas, areas indicative of important bottoms.

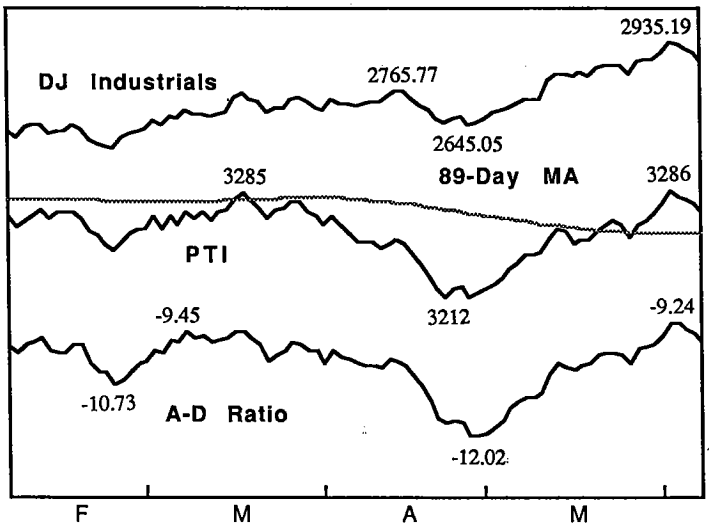
Now let's turn to the market and see what's been happening. For one thing, the Dow has been making a series of record highs.

On June 4 the D-J Transportation Average rallied above its preceding April and March peaks to close at 1207.84, a new high for the year. That's a secondary confirmation, it's impressive, but the June 4 close was still far below the record Transport high of 1532.01 touched last September 5.

The Utility Average is still well below its 1990 high of 236.23, recorded on January 2.

As noted in the last Letter, breadth on the NASDAQ and AMEX has been expanded. That's a much needed plus. Up to early May





whatever upside breadth the market produced was pretty much restricted to the NYSE.

So is everything fine and dandy? Well, there are still a few skeptics around. Joe Granville thinks we are seeing "a bull trap." So does Sindlinger and so does LaLoggia and so does Harry Schultz. I can't say I'm in love with the market myself. There are a number of things that bother me about what's happening.

First, the most recent rise sprang from a semi-oversold base, not a thoroughly oversold base. As a rule, market advances coming out of semi-oversold bases are violent, dramatic and relatively short-lived. On the other hand, market advances which stem from heavily sold-out bases tend to be steady, powerful and long-lived.

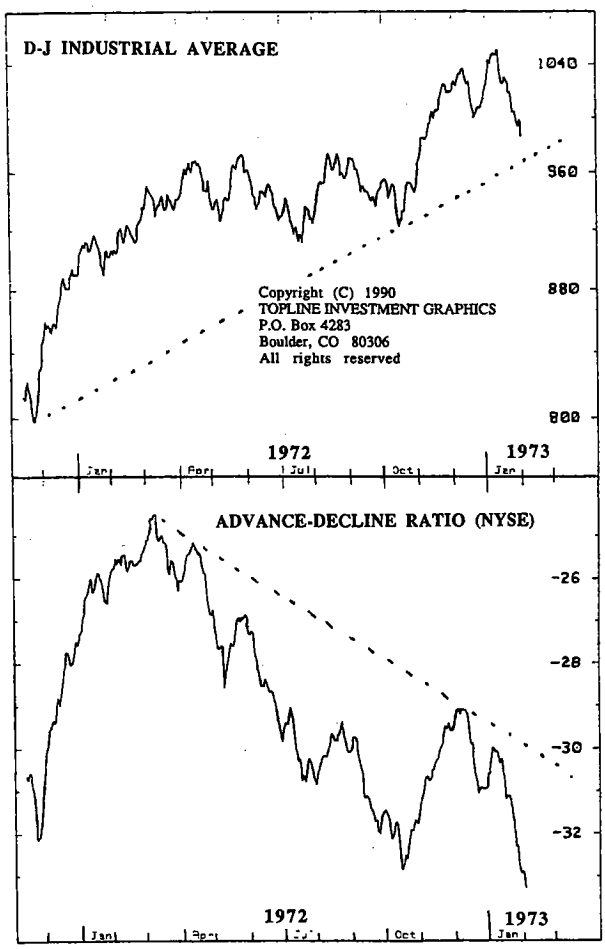
The flagrant non-confirmation on the part of the Transports continues to bother me, but at least (as of June 4) we have a secondary upside confirmation in that the Transports did better all of their 1990 preceding peaks.

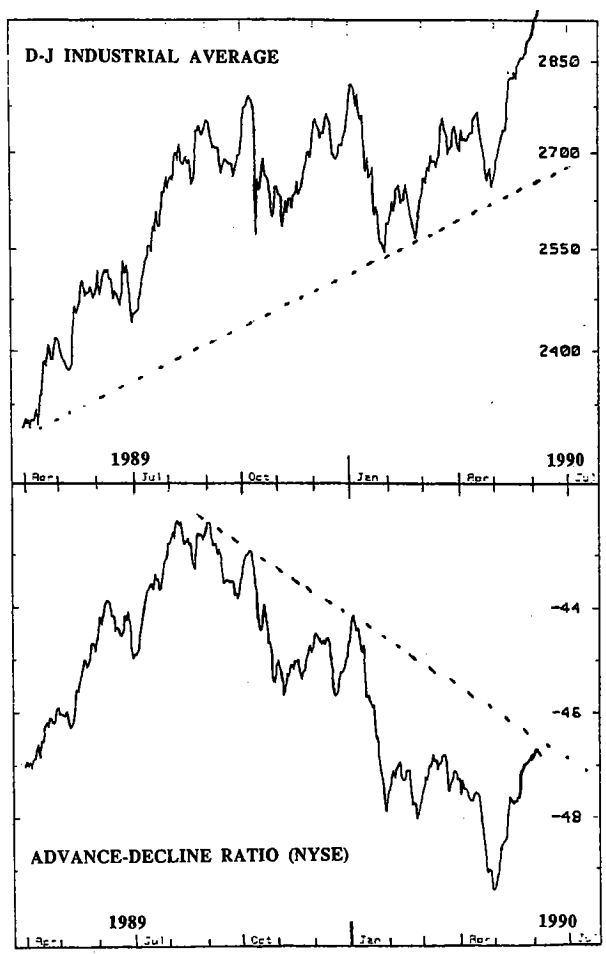
The phenomenon which I continue to wonder about (it keeps me cautious) can best be seen on the charts at the bottom of page 2. Computer whiz John Carder sent me these two fascinating price/breadth comparisons, and they certainly provide food for study. The first set shows the Dow and the A-D ratio from December 1971 through 1972 and into January 1973. The second chart shows the Dow and the A-D ratio during the current period -- from April 1989 to June 1990.

Note the startling resemblance in the price/breadth relationship in both periods. During October through November 1972 the Dow advanced sharply, leaping to a new record high in January 1973. At the same time the A-D ratio turned up strongly (in a move that was actually much more impressive than the action of the A-D today). But even so, at the Dow high in January 1973, the breadth failed, by a wide margin, to confirm. That final unconfirmed Dow rise was the prelude to the worst bear market (1973 though 1974) since the 1930s.

Now let's turn to the current situation. Today we see a striking ten-month series of divergences and non-confirmations between the Dow and the A-D ratio. Note that with the Dow rallying to new record highs, the A-D has failed to even better its nearest preceding peak (i.e., the March peak).

Obviously, no two markets are ever going to develop in exactly the same way. Nevertheless, I feel that the price/breadth comparisons in the two periods have developed so similarly that they are well worth studying. And in studying these two sets of charts you can certainly see that the potential for another major bear market exists today.





The real powerhouse of this market has been the D-J Industrial Average. All through the early-year breadth weakness, the Dow refused to decline with any degree of authority. I use my "directional up-down" indicator to trace the strength of the Dow, and I have shown this chart in recent Letters.

This daily indicator is based simply on whether the Dow advances or declines (the indicator makes no note of the extent of the move). Now study the Dow directional chart, page 6. Note that the uptrend remains intact. When this indicator finally traces out a declining trend, at that time we will know that the bear is in command.

I just received the latest issue of the authoritative *Bank Credit Analyst* (Canada, (514) 398-0653) and as usual it makes for very informative reading. "The stock market has bet that inflation will start to cool, interest rates will ease, and most importantly, that the US authorities will not sacrifice growth prospects to force down inflation. . . A major question facing investors is whether US authorities can continue to stretch out the economic and credit cycle that began in late 1982. . . There are two main economic and financial risks. The short-term risk is that the credit squeeze will intensify, that deflationary pressure will gain momentum and the US corporate profits will remain weak. The other risk is longer-term. Continuation of US growth at close to the full employment track will cause a persistent uptrend in inflation."

The *BCA* shows a long-term (back to 1954) chart of the stock market, corporate profits and the real money supply (M-3). In the past when profit margins and the money supply were in declining trends, as they are now, the market headed down. Thus, *BCA* believes the market is now "at serious risk . . . The last time that a major negative divergence between the stock market and the two indicators occurred was in 1987. This caused serious vulnerability and eventually led to the 1987 crash." Russell comment: In other words, the stock market is as vulnerable now as it was in 1987.

The *Bank Credit Analyst's* proprietary "Equity Investment Indicator" has turned bearish as has their Debit/Loan ratio (the latter over the years has been a good forecaster of corporate profits).

INVESTMENT POSITION: Last week saw a secondary upside confirmation on the part of the Transports. Nevertheless, the carriers are still more than 300 points below their bull market high -- so the bear stays in the box. He who growls last growls best.

As far as buying the last advance, call me "the sissy." Declining corporate profits, collapsing growth rate in the broad money supply, declining debit/loan ratio -- I'll wait. I don't have to buy every market advance, and that one was too "high risk" for me.

WHAT I SEE: I'm going to offer up some personal opinions in this section. Frankly, I don't like the picture today, and my own opinion is that the best risk/reward situation for the average investor today is in T-bills or a well-managed money market fund. In these, one receives an historically high rate of return (around 8%) with a minimum of risk.

Today, corporate profits are in a downtrend and the broad money supply (M-4) is also in a downtrend. Historically, when both of these phenomena are in place at the same time, the market has been at high risk, which is where I believe it is now -- at very high risk.

On top of that a credit crunch is building. The banks, suffering massive loan losses, are growing increasingly reluctant to make loans. They're frightened. You can see it as they descend upon Donald Trump's heavily leveraged empire.

Despite its policy of keeping interest rates fairly high, the Fed has been frustrated by its inability to bring inflation rates down. The Fed's policy of slow economic growth has failed to halt inflation. Inflation stays stubbornly in the 5-6% area (and many feel that these inflation figures are fudged).

The federal government's budget remains a disaster with the total deficit growing at the rate of over $300 billion a year. Furthermore, the government sponsored enterprises (GSE's) are on shaky ground. The 1989 losses were $14 billion for the credit programs, $4.2 billion for the Federal Housing Authority and $2 billion for the FDIC. Meanwhile, the cost of the S&L bailout sails out into space.

If this nation goes into recession I believe the shocker will be that interest rates will go UP, not down. A recession would force thousands of debt-logged corporations against the wall, in which case they would attempt to borrow from the already frightened banks. A money squeeze would emerge. The banks would be reluctant to lend -- rather they would be trying to protect themselves by calling in outstanding loans (as they are now doing with Trump).

In a recession, corporations would want money at almost any price in order to stave off bankruptcy. This would precipitate a disastrous credit crunch with an accompanying interest rate spike. Such a spike, by the way, would (I believe) be a spectacular time to buy high-grade debt paper in the five- to ten-year maturity range.

Each week I talk to businessmen across the nation, and what I hear is that there is a huge division between the action in large companies and those of the medium to small companies. In general, those who are not working in giant high-cap companies are experiencing hard times. Many industries are in recession. Many people are afraid of losing their jobs. If you're in autos, if you're in real estate, if you're in finance or on Wall Street, if you're in retail -- it isn't easy.

But I continue to believe that the crux of the situation lies in the realm of real estate. The price structure of the nation's real estate must hold. If the real estate price structure softens across the board all hell is going to break loose. America's savings are in its homes.

In order to float (or hold up) the $10 to $12 trillion in debt that is now built into the US economy, we have to have inflation, and I mean the current inflation rate of around 5%. Let inflation drop towards zero or let deflation enter the picture, and you're not going to believe the trouble that surfaces.

Remember, many of the "deals" and loans that have been made over the past ten years (again, ask Donald) have been with the expectation of ever-rising asset values, better known as inflation. But today we have a situation where there is massive overbuilding in commercial real estate, where recession or semi-recession conditions exist in a majority of the states, and where many categories of goods are actually deflating (or at least being discounted).

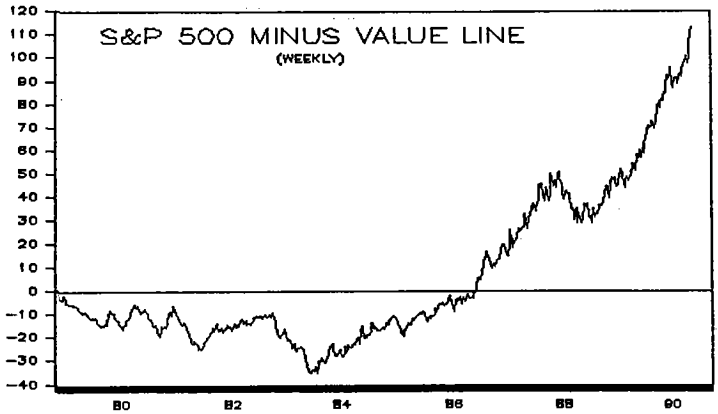
So as I see it, it's an economy that is up to its neck in debt, an economy that can no longer depend on inflation to bail itself out of that debt. Furthermore, the US finds itself in a global situation where it no longer calls the tune. We owe the money, and the guy that owes the money isn't in command, his creditors are. Of course, our creditors know that if we go under, they'll probably go with us, so nobody in Europe or Asia wants to see the US fall apart. Yet, when the debt hits the fan you can bet it will be "every man for himself and every nation for itself."

If the US drowns in its own debt (and remember, the Government is accumulating debt at the rate of $6 billion a week), I honestly don't know how we're going to get out of the mess. The classic method has been via inflation, but the rest of the world won't stand for that. For instance, even hint that the US is going to depreciate the dollar, and you'll have all our creditors dumping Treasury bonds, thereby sending interest rates though the roof.

No, I don't have answers any more. Twenty or even ten years ago I thought I had answers, but the situation has gone too far. The crisis isn't a matter of whether -- it's when. How dare I make that statement? I make it on authority -- the authority of compounding debt and the compounding interest on that debt.

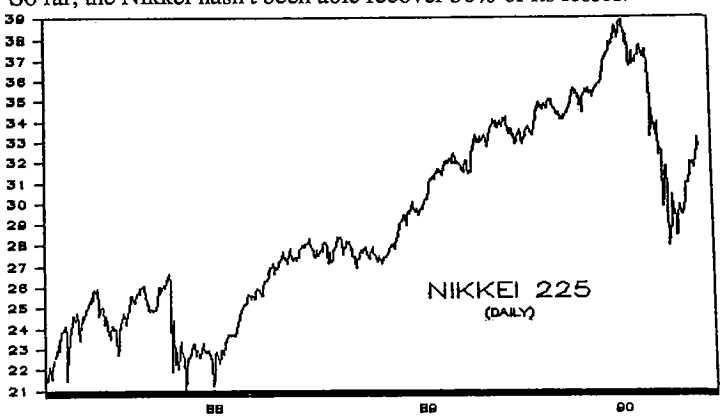
Final thought: We have a "happy president," a "don't make waves" president. A few weeks ago Mr. Bush called for a special meeting of select Congressmen and stated that as far as the budget was concerned, everything was on the table. Then Bush and the conference disappeared into the Washington woodwork, and I haven't heard a damn thing since. Bush isn't leading, he isn't telling Americans the truth, he's hoping that the budget disaster will somehow go away. And it will -- when they abrogate the law of compounding.

CHART PERSPECTIVE: Here are two charts well worth studying (charts courtesy of Paul Eldridge and the *Ruff Co.*). This chart shows the S&P 500 minus the Value Line. The S&P is weighted for capitalization so the high cap or big stocks move this Average. The Value Line is not weighted for capitalization so it represents all stocks or the average stock. What we see here is a trend (ever since 1984) towards the big stocks. Over the last six years it is apparent that the markets have favored big over small. How long this trend will last is anyone's guess, but my guess is that today the stocks (and they tend to be the biggies) with international capabilities are the stocks that have a major advantage.



The next chart shows the important and widely-followed Nikkei 225. Here are Paul Eldridge's comments: "Through April 30 the Nikkei 225 had recovered 45.12% of its January-April decline. With a top-to-bottom drop of 10,913 points (38,914, the peak of 12/31/89, down to 28,002, the low of 4/2/90) a Nikkei close at 33,458 would represent a 50% retracement. A close above 33,458 would have bullish implications."

So far, the Nikkei hasn't been able recover 50% of its losses.



NOTES & QUOTES: The states and municipalities and cities are having their troubles, and the troubles have to do with out-of-control budgets, deficits and new taxes. Eyeing these troubles are the rating agencies such as S&P and Moody's. The raters are watching NY state closely now, since it has the third lowest-rated paper of any state in the nation. NY now wants to issue $1.4 billion in new bonds. California, with its $3.6 billion deficit, is also receiving the attention of the raters, since it is being hit via declines in the defense industry and also since home prices are finally starting to soften in the Golden State.

* *

Speaking of home prices, read on -- You may not like rock'n'roll, but David Geffen does. He sold his record company earlier this year to MCA for a whopping $545 million in stock. Then he turned around and bought Jack Warner's home along with all its contents. The estate boasts a separate house with seven to ten bedrooms for servants. Geffen paid $47.5 million in cash for the place. This is believed to be the the largest amount ever paid for a private home in the US.

* *

Following the*WSJ's* front page piece on the liquidity problems of Donald Trump, the NY papers went into a news feeding frenzy. The *NY Post* described how Donald "humiliated" his brother, Robert, at an April corporate meeting, after which Robert quit as CEO of the Taj. On June 7 the *NY Times* published a front page rundown on the whole Trump situation replete with charts and graphs.

* *

I mentioned in the last Letter the thesis that certain Japanese industrial barons have dreams (plans) for economically taking over the world. Silly idea, but I don't find myself laughing. The *NY Times* (May 29) in a headline article notes that "As Hong Kong's Elite Leave, Investors from Japan arrive." The *Times* continues, "Japan's approach has been to build up steadily, assuming that liberals and hardliners will come and go but that all will discover the lure of Japanese capital. There are more than 50 Japanese banks in Hong Kong now, with effective veto power over big projects like the $16 billion airport the Hong Kong government is trying to build. There are also more than 30 Japanese securities firms in Hong Kong." Russell comment: While many wealthy Hong Kong businessmen are leaving Hong Kong, the Japanese are moving in. The Japanese believe they are too powerful for the Chinese to confront , and that the Chinese will need Japanese capital and know-how.

* *

From the *Asian Wall Street Journal* (May 28) comes this story: "Japanese Say Their Surpluses Benefit the World's Economy." Japanese bankers justify their surpluses and maintain that Japan's huge trade surpluses can help fund the cost of unifying Germany and rebuilding Eastern Europe as well as covering the US's chronic budget deficits. Russell translation: Japan loves its surpluses, and the Japanese will continue to use them to extend their influence over Europe, Asia and the US. Believe it.

* *

Facts: There are a million people on welfare in LA County. . . . The numismatic (rare) coins market has dropped 25% since the first of the year. . . . Sport memorabilia is booming. Retail sales of Major League Baseball licensed merchandise hit $1 billion last year, while NFL Football merchandise hit $750 million. . . . The new Excalibur hotel in Vegas will open soon. It will be the world's largest hotel with 4,032 rooms. When the Excalibur opens it will give Vegas a total of 75,000 hotel rooms, almost twice as many as New York's 47,000 rooms. . . Joe Montana, 49ers' quarterback, will receive a salary of $4.6 million next year, $16 million over the next four years, an NFL record. . . Productivity for US workers fell 2.7% last month, biggest drop in nine years (mmm, we'll have to do a lot better if we want to compete in the new global economy).

* *

Interesting Quotes: "There's not a car company in the country today making money on the North American market, and I mean not just US companies but foreign companies as well." Gerald Greenwald, Chrysler VP. . . . How about this one from Pat Buchanon?: "There's no question but that this S&L thing is a disaster, a debacle. You know, Ollie North transferred $2 million, it is said, to the *Contras*, and we had the Tower Commission, a joint congressional investigation with public hearings and a special prosecutor. We now hear that the S&L thing may cost $500 billion and there's no commission, no special prosecutor and no joint congressional investigation." Russell comment: Well I'll be darned. But you know, there are a lot of Senators and Congressmen who want to remain anonymous on the "S&L thing." And I mean VERY anonymous.

* *

If you're old enough to remember Walter Winchell, you'll probably be fascinated by the new book, "Walter Winchell" (Knopf) by

Michael Herr. It's written in a marvelous new literary form -- part novel, part reality, part movie scenario. I couldn't put the book down, read it in two sittings.

* *

Quote of the month: "Gramm-Rudman in private conversations is considered a farce. The bill puts up public numbers, but most members I talk to realize it's a farce." Jim Jones, former Okla. Congressman.

Second quote: "It is time for us to look at some basic reforms in the process of how we spend money in this country. I'm talking about a process which is a shell game, a game of three-card monte instead of a direct process where the American people can understand what their money is being spent for." Nicholas Brady, Treasury Secretary.

* *

Last week I was glancing through one of my kids publications entitled "Zoobook", and I discovered the following astounding items: The fastest two-legged animal is an ostrich -- it can run 35 MPH. The fastest snake is the deadly mamba, which can crawl 12 MPH. The jackrabbit can run an incredibly fast 45 MPH. The peregrine falcon will dive at speeds up to 200 MPH. The fastest fish, the sailfish, can overtake submarines by swimming 68 MPH. The sperm whale can hold its breath under water for two hours. The bar-headed geese of Asia regularly fly over Mr. Everest at a height of over 29,000 feet. The world's greatest traveler, the Arctic tern, flies from the North Pole to the South Pole and back every year, a round trip of 20,000 miles. The flea is the world's greatest jumper; it can jump 200 times its own body length, equal to you jumping to the top of a 50-story building. An ant can lift 50 times its own body weight, equal to you lifting your car over your head. The world's biggest mammal, the blue whale, has a heart six feet long weighing 1200 pounds. A man could easily crawl through the blue whale's aorta. The world's smallest mammal is the bumblebee bat. It weighs less than a penny and is the size of a bumble bee. The world's largest insect is the tropical stick insect; it is a full (ugh) 13 inches long.

* *

Do more people die via murder or suicide? Surprise -- suicides outnumber murder three to two (30, 796 suicides in 1987 vs. 21,103 murders). Murders receive much more publicity, however.

* *

Women: 86% of all personal wealth in America is controlled by women. Women comprise 62% of America's shareholders. Women pay 61% of all family bills. What's the secret of this amazing woman power? It's that 75% of all married women OUTLIVE their husbands.

* *

Want the lowest cost discount brokers in the nation? Here they are: K. Aufhauser & Co. of NYC [(212) 246-9431], Pacific Brokerage of Los Angeles [(213) 939-1100], Barry Murphy & Co. of Boston [(617) 426-1770], Waterhouse Securities of NYC [(212) 344-7500]. However, most of these are only dirt cheap when it comes to even lot trades (for odd lots, very few brokers offer bargains -- in fact, I can't find any).

* *

How's this for irony, or you might term it insanity? While the Soviets are standing in line for food and the barest household items, they continue to spend massive amounts on their military. I read the following and scratched my head. Of course, the answer is that the Soviet bureaucracy (like the US bureaucracy) is so huge, so bloated, so inefficient and so stupid that it's left hand can starve while it's right hand is spending its head off.

United Press International

LONDON — The Soviet navy is scrapping its vintage vessels but replacing its surface fleet in tonnage at the highest rate in more than 20 years to strengthen its offensive capability.

Jane's Information Group, the authoritative defense analysis organization, this week released its 1990-91

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What about this: the US borrows billions of dollars from foreigners each month to cover its budget deficits, and at the same time the US gives billions of dollars to other nations. With that kind of fiscal insanity, how does the dollar hold up? The answer, of course, is that over any extended period of time the dollar doesn't hold up -- it depreciates.

* *

Congress is frantic to dig up sneaky new taxes, mostly aimed at those who earn $70,000 or more. A House Ways and Means proposal under study would set new limits on tax-free gifts. Under current law, you can give up to $10,000 per year tax-free to as many people as you want ($20,000 if you're married). Anything above those limits is taxed starting at 37%. But the new proposal would limit you to a total of $30,000 in tax-free gifts ($60,000 if you're married). . . . Here's another proposal the House is thinking about. They want to wipe out the non-spousal estate-tax deduction. Today's law allows you to leave $600,000 from your estate to people other than your spouse tax-free. But the new proposal would wipe out this $600,000 exemption and tax anything left to your kids or to heirs, other than your spouse.

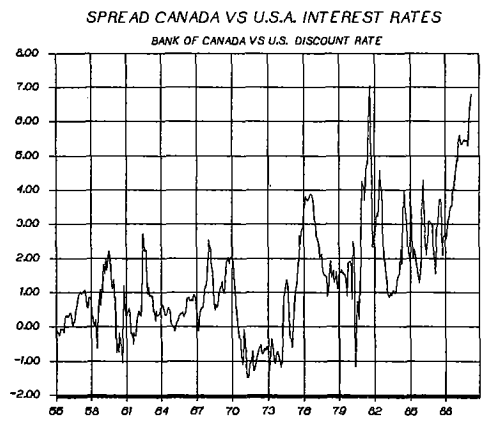
So what do we do now? WRITE and complain to the House Ways and Means Committee, 1102 Longworth House Office Building, Wash., DC 20515, and the Senate Finance Committee, US Senate, Dirksen -- Room 205, Washington, DC 20510. Congressmen do respond to pressure.

* *

On May 29, 30, 31, *USA Today* ran a series on the grave problems at many US banks. The paper ran a list of 540 individual banks whose "problem assets" (bad real estate loans, repossessed property, etc.) exceed their assets plus loan-loss reserves. The articles and the bank listings, stated *USA Today,* drew "heat" from the banks. The article zeroes in on one of the banks' problems -- loans on bum real estate. "The USA has a record 465 million square feet of vacant office space," states the article. "That's equal to the combined office space in Washington DC, Chicago and Dallas."

* *

With Quebec threatening to pull out of Canada (politically, that is), all eyes are on the Canadian dollar. This chart of the spread between Canadian and US interest rates is significant. As you can see, the spread is almost at the 1982 record spread of over 7%. Part of the huge premium paid by Canadian paper is due to Canadian inflation and the rest is probably due to the market's nervousness about Quebec. The Canadian central bank has been boosting its discount rate as it moves to stabilize the Canadian dollar. So far, the fat rates have done the trick, and the "Northern dollar" has held fairly steady over the last few weeks.



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The next powerhouse and fastest growing area of North America will be the "New Pacific." This area will include Washington, Oregon, perhaps Idaho and Montana, as well as the Canadian provinces of British Columbia and Alberta and parts of the Yukon. The new Pacific region is larger than the 12-nation European Community. It has a total population equal to Sweden's and Norway's combined. It's economic and cultural center is the Seattle-Vancouver corridor. The region can be compared in size and potential to California. It's an area of 20 million people and it's

a major exporter of natural resources and technology. The major problem -- will the area have the political will to join forces and launch cooperative enterprises?

* *

If you own any debt paper you may wonder how a change in interest rates will affect the market value of your paper. This chart (courtesy of *Value Line*) provides a pretty good idea, based on one-point changes up or down.

Expected Change In High-Grade Bond Prices Per Percentage Point Change In Yield

Maturity	-1 Point	+1 Point
2 Years	+$1.80	-$1.77
4 Years	+$3.38	-$3.25
10 Years	+$8.90	-$7.92
30 Years	+$11.86	-$9.88

* *

Stanford Law and Policy Review, in a comprehensive study based on the Office of Budget and Management and the General Accounting Office, comes up with some shocking figures on the S&L bailout. The study states that the cost will come to $456 billion over the ten year period from 1989 to 1999. BUT the cost will keep rising as taxpayers put up the money to pay off bondholders! The study extends the costs out to 40 years (since the bailout bonds go out that long). The total cost, figuring interest, then climbs to a mind-blowing $1.369 trillion. Russell comment: This will give you a hint as to how much new money will have to be created in coming years.

GOLD, PRECIOUS METALS: It is clear that the metals have been responding to certain deflationary forces in the US economy. Business is sluggish, capital spending plans are down, the commodity indices are going nowhere, home prices are weak, vacancy rates for commercial buildings are high throughout the nation, car sales are slow, and even New York's gourmet restaurants are under pressure to reduce their prices. Furthermore, the declining rate of credit creation and the low growth rate of the broad money supply add to the deflationary pressures.

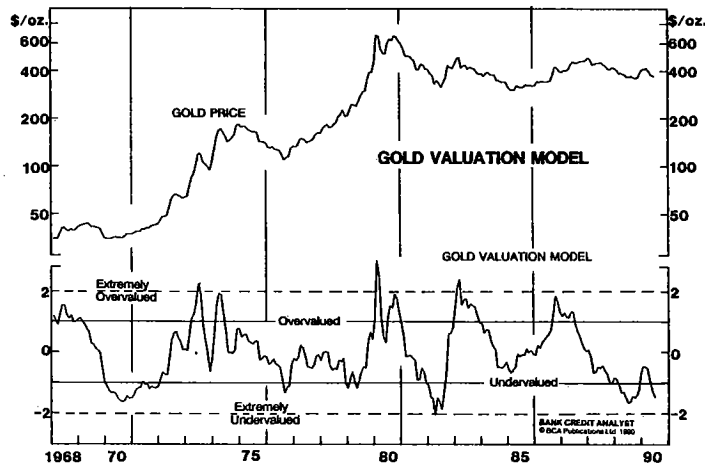
Finally, interest rates remain high and attractive to conservative investors. So the cost of holding gold in comparison to holding dollars is expensive, and the average American would rather collect 7.9% on T-bills than hold gold.

Short-term sentiment towards gold and the precious metals has turned intensely, black- bearish, with all sorts of rumors and predictions to the effect that gold is no longer a hedge against inflation, deflation or anything else. If an item, any item, is going to form a bottom, this is the kind of sentiment that is needed.

Long-term holders of gold have two things going for them. (1) The power of compounding (and I'm talking about the compounding of the rocketing federal debt and the compounding of the interest on that debt). (2) The cowardice and duplicity of Congress and the Administration. While Congress and the White House conjure up new ways to confuse or hoodwink the public, the federal debt continues to rise and compound -- at the rate of over a billion dollars for each working day in the year. Rise in US federal debt (latest figures) for the last 12 months -- $319 billion.

Under these conditions, ultimately the value of the dollar or the solvency of the United States must come into question. As the staggering rise in debt goes on, one must wonder if US Treasury debt won't finally end up as the greatest mountain of junk bonds of all time. Of course, when even a hint of this possibility dawns on the consciousness of investors, the metals will begin to have their day.

The latest issue of the *Bank Credit Analyst* publishes a chart of their "Gold Valuation Model" based on currency fluctuation, changes in liquidity, inflation and interest rates. As you can see, gold is now deep in the "undervalued" zone. *BCA* states that gold in now in "a good buying area for long-term value-oriented gold investors." Those are my sentiments as well.



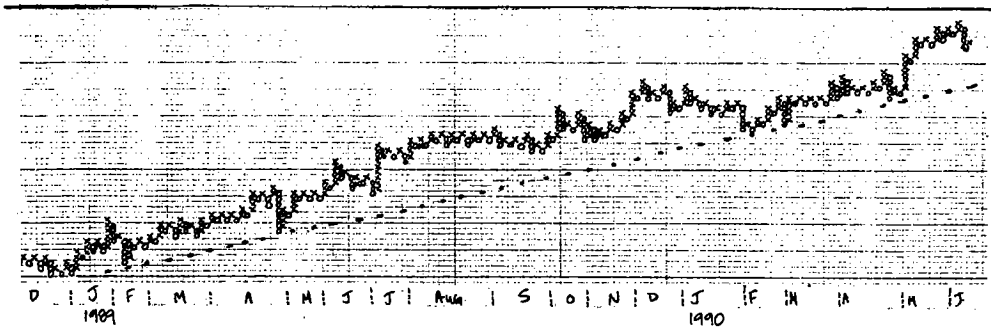
LATE NOTES: On May 21 the PTI broke out above its 89-day moving average, advancing to a June 4 peak of 3286. From there the PTI turned down again, and as this is written the PTI has declined -- but is still 14 points above of its MA.

The recent action puts the PTI in the bullish mode -- but the market is also quite overbought. Every major market rise of the last 20 years has begun with the PTI in the bullish mode. Conversely, however, simply because the PTI has moved into a bullish mode does not guarantee a major rise. As you can on the page 2 chart, the PTI has actually been quite indecisive all through 1990. And in view of the persistent split between price and breadth, I'd have to describe the market's action in 1990 also as "indecisive."

Final Note: On Friday (June 8) the McClellan Summation Index (based on the action of two moving averages of breadth) gave a sell signal. In view of this sell signal, it will be very instructive to see how much damage will be done and whether the PTI will be able to hold above its moving average.

Final Comments: Congress has all but decided to take Social Security off budget. If so, they're going to be dealing with a budget deficit that will be mind-boggling. The latest 12 month increase in the Federal debt is $331 billion -- that's **$331 billion!**

The worried banks are tying up Donald Trump tighter than a drum. The're loaning Trump $50 million and allowing him to skip payment on $2 billion in loans. In return Trump had to pledge some of his assets that aren't collateralized (and there aren't many). If real estate prices stay soft, Trump's next book may be titled, "How I ran a billion dollars into a shoestring."



This is my "directional chart" of the Dow, based simply on whether the Dow advances or declines on each successive day. The trend of the Dow has remained bullish, despite the extraordinary divergence (decline) in breadth.

When this directional chart turns down, the strongest element in the market will have turned bearish.

NEXT MAILING: June 27